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RUEHIN/AIT TAIPEI 0246  
RUEHBK/AMEMBASSY BANGKOK 0066  
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RHMFIUU/DEPT OF HOMELAND SECURITY WASHINGTON DC 0052  
RUCPDO/DEPT OF COMMERCE WASHDC  
RUEATRS/DEPT OF TREASURY WASHINGTON DC 0188  
RHMFIUU/DEPT OF JUSTICE WASHINGTON DC 0046  
RUCNFB/FBI WASHINGTON DC 0041  
RHEHAAA/NSC WASHINGTON DC 0088  
RUEAIIA/CIA WASHDC 0308  
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SENSITIVE  
SIPDIS

State for EAP/CM; EAP/EP; EEB/IPE; EEB/TPP; EEB/CIP  
State for INL - Jvigil  
USTR for China Office; IPR Office; and OCG  
Commerce for National Coordinator for IPR Enforcement  
Commerce for MAS - RLAYTON, SMATHEWS  
Commerce for MAC - ESzymanski, SWilson  
Commerce for MAC - NMelcher, JWu  
USPTO for Int'l Affairs - LBoland, EWu  
LOC/Copyright Office - STEpp  
Treasury for OASIA - Dohner, Winship  
DOJ for CCIPS - MDuBose, SChembtob, TNewby  
FTC for Blumenthal  
FBI for LBryant  
DHS/ICE for IPR Center - THipelius, TRandazzo, DFaulconer  
DHS/CBP for IPR Rights Branch - GMCCray, PPizzeck  
ITC for LLevine, LSchlitt  
State Pass White House OTP Ambassador Richard Russell  
NSC for JBader, JLoi, JShrier

E.O. 12958: N/A

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SUBJECT: U.S. SOUTH CHINA COMPANIES REVIEW WEAK IPR ENFORCEMENT  
PROBLEMS WITH SECRETARY LOCKE AND AMBASSADOR HUNTSMAN

Ref: A) Guangzhou 619, B) Guangzhou 611, C) Guangzhou 320, D)  
Beijing 570

11. (SBU) Summary: Intellectual property right (IPR) infringement -- including counterfeiting, unlicensed technology transfer, hard-disc piracy and unauthorized internet distribution of copyrighted content -- cost U.S. firms in south China hundreds of millions of dollars in lost revenue and pose a serious threat to future operations, according to executives who met October 27 with Commerce Secretary Locke and Ambassador Huntsman. Poor quality patents, the lack of coordination of IPR enforcement, and public sector procurement practices based on discriminatory indigenous standards are additional challenges that companies face in the regional business environment. Strategies for navigating IPR-hostile terrain proposed by the business leaders include local registration of companies and building positive relationships with relevant IPR authorities and local distributors. Despite IPR challenges, the business potential of the China market continues to attract U.S. companies. Participants at the meeting highlighted the critical role the Consulate's Foreign Commercial Service Office plays in providing assistance to small- and medium-sized companies. End Summary.

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WEAK IPR ENFORCEMENT A THREAT TO FUTURE OPERATIONS  
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12. (SBU) Pervasive infringement of IPR costs U.S. companies hundreds of millions in lost revenue every year, and has forced some companies to seriously consider relocating R&D activities outside of Guangdong province, according to business leaders who met with Ambassador Huntsman and Commerce Secretary Locke during their visits to Guangzhou. Jim Sherriff, Chairman and CEO of Cisco China, told the senior U.S. visitors, during a breakfast hosted October 27 just prior to the Innovation and Intellectual Property Forum (see reftels regarding the Forum and related meetings) by the American Chamber of Commerce in South China (AmCham South China), that weak IPR enforcement not only poses a threat to U.S. business operations in the province, but also to Guangdong's stated objective of attracting research and development (R&D) investment to develop innovative technologies and move up the value chain. The principal source of IPR problems, according to Sherriff and other business leaders, is not so much the lack of IPR laws or regulations but, instead, uneven enforcement between and among provinces and even cities and the lack of severe criminal penalties that could deter illegal behavior.

13. (SBU) U.S. companies in the entertainment sector have been particularly hurt by weak IPR enforcement. Hugh Stevens, Senior Vice President of Time Warner Asia, explained that Guangdong was the largest source in China of pirated CDs and DVDs, many of which are exported overseas. The entertainment industry is also hurt by the lack of a regulatory framework for internet distribution of copyrighted content, which makes it easy for internet users to

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freely download copyrighted movies and music without authorization. In addition, Stevens pointed out that online and hard-disc piracy was facilitated by the absence of an anti-camcorder law at movie theatres and concerts.

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LABOR LAWS ALSO A CHALLENGE TO IPR PROTECTION  
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14. (SBU) Already weak IPR enforcement in the region has been further hampered, according to David Hon, CEO and founder of Dahon, a leading bicycle manufacturer, as a result of new labor laws that make it difficult to prosecute employees who steal company secrets. Hon said that Chinese companies were currently offering to double the salaries of engineers in leading R&D labs to entice them to walk away with confidential material and marketable technologies. No laws currently exist, according to Hon, to prohibit employees from taking trade secrets to rival companies. In addition, companies cannot compel employees to sign non-disclosure agreements or standard agreements against working for a competitor for at least two years, Hon said.

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LOW-QUALITY PATENTS PART OF THE PROBLEM  
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15. (SBU) While many Guangdong officials respond to criticism of the IPR enforcement regime by noting that the province leads China in patent applications, according to Myron Brilliant, Senior Vice President of International Affairs at the U.S. Chamber of Commerce, the "first-to-file" incentive has resulted in a huge number of low-quality patents, confounding enforcement efforts. Brilliant also said that the lack of coordination among local IPR authorities -- e.g., the Public Security Bureau, the Intellectual Property Office, and Customs -- poses a separate challenge to IPR protection efforts. The fact that local police often restrict their intervention to confiscating counterfeit goods but not the equipment used in their production was another example given of weak IPR enforcement.

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LOCAL REGISTRATION AND RELATIONSHIP BUILDING ARE KEY  
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¶6. (SBU) Daniela Riccardi, President of Procter and Gamble (China), told the Ambassador and Secretary that her firm and some other U.S. companies had decided to "learn to live with counterfeiting." She said that, while 15% of Procter and Gamble's product lines were counterfeited, the company had made progress in working with local authorities to fight the problem. Riccardi attributes this progress to the fact that her company is locally registered and is therefore a significant source of tax revenue. Tim Wen, Vice President of

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Allway Co., added that the best strategy for obtaining help from IPR authorities is for companies new to the region to work immediately on building cooperative relationships with high-level officials and local distributors. Wen recommended face-to-face meetings with officials to develop relationships, and said that local distributors needed to be educated on the importance to industry of IPR protection.

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STRICTER IPR REGULATIONS MAY COME AT COST OF MARKET ACCESS  
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¶8. (SBU) Rampant copyright infringement affects U.S. small- and medium-sized enterprises (SMEs) as much it affects large multinationals. Jung Brannen, CEO of TRO, a health-care architecture firm, told the Ambassador and Secretary, in a lunch later on October 27 with U.S. SME executives, that local copying of designs posed a significant challenge to his business. Fear of copycat activity has led Fluidmaster, a U.S. toilet-bowl manufacturer, to keep its R&D operation in the U.S., despite localizing other aspects of its operation to China. President and CEO Alfred Ng of Mammoth, an air-conditioning company, described the need to rely on constant innovation to prevent Chinese competitors from mimicking technology.

¶8. (SBU) However, John Chen, Chairman and CEO of an IT firm called Sybase, argued that measures to strengthen IPR enforcement could have a counterproductive effect. In particular, Chen noted that, in the name of IPR protection new patent and copyright regulations could be used to effectively discriminate against foreign companies. Chen cited the development of indigenous standards for information-technology products as an example of an onerous regulation that, combined with inherently discriminatory public-sector procurement practices, had resulted in decreased market access for U.S. companies. In Chen's view, if the U.S. pushes for too much legislation, the result could amount to winning the battle, but losing the war on IPR.

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CHINESE MARKET POTENTIAL ATTRACTIVE DESPITE IPR CHALLENGES  
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¶9. (SBU) Nevertheless, the growth potential of the Chinese market continues to attract U.S. companies despite the challenges posed by weak IPR enforcement. AmCham South China President Harley Seyedin emphasized that 100% of the 1,600 AmCham member companies operating in south China were profitable last year in spite of the global economic crisis. Seyedin pointed out that 72% of the goods and services produced by Amcham companies last year were destined for the Chinese domestic market, up from less than 30% in 2003. Riccardi of P&G referred to the company's China operation as the key engine of future growth, noting that relatively low GDP per capita

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levels in China represent significant growth potential. General Manager Neil Wang of Covanta, a waste-to-energy producer, and General Manager Howard Hou of LP Amina, a clean coal technology provider, also highlighted the opportunities they see in China with the government's increasing attention to clean energy and emissions reductions, and the importance of staying tuned to the ever-changing business environment.

¶10. (SBU) Representatives from Fluidmaster, Mammoth, and Suntech added that success in the rapidly growing and evolving Chinese

market requires not only access but "localization," or adaptation of products to local tastes and preferences. They noted that working with local design institutes to adapt products developed abroad had been critical to their success in China's domestic market. U.S. SMEs in attendance emphasized the vital role the U.S. Consulate's Foreign Commercial Service office plays in supporting their market entry and expansion in the China market.

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